



GUIDELINES ON THE APPLICATION OF SUBSECTIONS 12(3) AND 12(4) OF THE INCOME TAX ACT 1967 IN DETERMINING A “PLACE OF BUSINESS”

1. INTRODUCTION

The objective of this Guidelines is to provide clarification on the application of subsections 12(3) and 12(4) of the Income Tax Act 1967 (ITA) in determining the “place of business” of a person in Malaysia.

2. SCOPE OF CHARGE

2.1 The introduction of subsections 12(3) and 12(4) of the ITA effective from 28 December 2018 provides for the determination of income from a business derived or deemed to be derived from Malaysia with the existence of a “place of business” in Malaysia. These provisions were introduced in Budget 2019 and have been gazetted in the Finance Act 2018 [Act 812].

2.2 The application of subsections 12(3) and 12(4) of the ITA would not affect the scope of subsections 12(1) and 12(2) of the ITA. Where business operations are carried on in Malaysia, the business income derived is subject to the ITA. Despite the absence of a place of business in Malaysia, business income may be deemed to be derived from Malaysia and is subject to tax due to business operations carried on in Malaysia.

Example 1

Mr. X, a non-resident¹ operates a food truck business. During festive seasons he would travel to different locations in Kuala Lumpur to sell his products. Mr. X does not have a specific physical place of business but his customers would know of his whereabouts through the information posted in his social media.

Income from the sale of his products is deemed to be derived from Malaysia under subsection 12(1) of the ITA despite not having a place of business in Malaysia.

- 2.3 In certain circumstances it is unclear whether business operations are carried on in Malaysia. However, if it is established that a “place of business” under subsections 12(3) and 12(4) of the ITA exist, the said provisions deem any income that is attributable to such “place of business” as derived from Malaysia.

Example 2

A Co., a non-resident company distributes its products in Malaysia through an agent in Malaysia. Upon receiving an order, the agent fills the order and delivers the products directly to the customers in Malaysia.

A Co. may be deemed to have a “place of business” in Malaysia under subparagraph 12(4)(ii)(C) of the ITA.

- 2.4 If the non-resident person is a tax resident of a country which has a Double Taxation Avoidance Agreement (DTA) with Malaysia, it is necessary to refer to the relevant DTA to determine whether the non-resident person has a permanent establishment in Malaysia. The provisions of the DTA shall prevail.

¹ Please note that all references to “non-resident” in the examples in this Guidelines refer to non-residents from jurisdictions which do not have tax treaties with Malaysia. For tax purposes a non-resident means other than a resident under sections 7 and 8, and subsection 61(3) of the ITA.

3. APPLICATION OF SUBSECTIONS 12(3) AND 12(4) ITA

3.1 Subsection 12(3) of the ITA states that the income of a person from a business that is attributable to a place of business in Malaysia is deemed to be the gross income of that person derived from Malaysia from the business. In other words, a person is deemed to derive income from a business in Malaysia if that income can be associated with the existence of a **“place of business”** in Malaysia.

3.2 Subsection 12(4) of the ITA provides that a “place of business” includes:

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop;
- (f) a warehouse;
- (g) a building site, or a construction, an installation or an assembly project;
- (h) a farm or plantation; and
- (i) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3.3 Subsection 12(4) of the ITA also deem a person to have a “place of business” in Malaysia if the person:

- (a) carries on supervisory activities in connection with a building or work site, or a construction, an installation or an assembly project; or
- (b) has another person acting on his behalf who:
 - (i) habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification;

- (ii) habitually maintains a stock of goods or merchandise in that place of business of the person from which such person delivers goods or merchandise; or
- (iii) regularly fills orders on behalf of the person.

Physical “place of business”

3.4 To determine whether a physical place would constitute a “place of business” in Malaysia would depend on the facts of each case. The activities performed by a person will determine the existence of a “place of business”.

3.5 Subsection 12(4) of the ITA provides a non-exhaustive list of examples of physical places that constitute a “place of business”. The term “place of business” covers any premises, facilities or installations used for carrying on the business of a person whether or not they are used exclusively for that purpose. A “place of business” may also exist where no premises are available or required for carrying on the business of the person and it simply has a certain amount of space at its disposal, regardless of whether the place is owned or rented by that person. Whether a physical place may be considered to be at the disposal of a person would depend on that person having an access to use that physical place, the extent of the presence and the activities performed there.

3.6 The “place of business” must be fixed. Two critical components would be considered:

- (a) a certain degree of permanence at geographical point (the duration test)

A “place of business” can be deemed to exist only if a physical place has a certain degree of permanency. A physical place may, however, constitute a “place of business” even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time.

- (b) a specific geographical point (the location test)

The “place of business” of a person has to be a “fixed” one. However, there may be difficulties in determining a single place where business activities are moved between locations. In such situation, the determination of a single place of business will depend on the commercial coherence or geographical coherence factors.

Example 3

A mine constitutes a single place even though the business activities may move from one location to another in a very large mine as it constitutes a single geographical and commercial unit for the mining business.

Example 4

A pedestrian street or outdoor market in different parts of which a trader regularly sets up his stand represents a single place for that trader.

Preparatory or auxiliary

- 3.7 Certain activities performed at a physical place may not be sufficient for that place to constitute a “place of business”. Where a physical place is maintained solely for the purpose of carrying on an activity which is of preparatory or auxiliary character, such place may not constitute a “place of business”. However, each case will have to be examined on its own merits. In general, activities of preparatory or auxiliary in nature includes the following characters that they:
- (a) are so remote from the actual realization of profit of the business that it is difficult to allocate any profit to the physical place in question;
 - (b) in itself do not form an essential and significant part of the activity of that business as a whole;
 - (c) are not identical to the general purpose of the whole business; or

(d) are usually carried out during a relatively short period.

However, if the overall activity by the person or its associated person resulting from the combination of preparatory or auxiliary activities constitute complementary functions that are part of a cohesive business operation, such activity would not be regarded as preparatory or auxiliary. The same result could be achieved if the overall activities consists of a combination of preparatory or auxiliary activities and other activities by the person and its associated persons.

Example 5

D Co., a company resident of State D, manufactures and sells appliances. M Sdn Bhd, a subsidiary of D Co., owns a shop where it sells appliances that it acquires from D Co. D Co. also owns a small warehouse in Malaysia where it stores a few large items that are identical to some of those displayed in the shop owned by M Sdn Bhd. When a customer buys such a large item from M Sdn Bhd, the employees from M Sdn Bhd would go to D Co.'s warehouse to take possession of the item before delivering it to the customer. The ownership of the item is only acquired by M Sdn Bhd from D Co. when the item leaves the warehouse.

In this case, the storing activities at the warehouse will not be regarded as preparatory or auxiliary. M Sdn Bhd and D Co. are associated persons and M Sdn. Bhd.'s shop constitutes a "place of business" of M Sdn Bhd. The business activities carried on by D Co. at its warehouse and by M Sdn Bhd at its shop constitute complementary functions that are part of a cohesive business operation. Therefore, the warehouse will be regarded as a "place of business" of D Co.

Building site, construction, installation, assembly and supervisory activity

- 3.8 For a building site, or construction, an installation or an assembly project, or supervisory activities in connection with building site, or construction, an installation or an assembly project, they will be regarded as a "place of business"

of a person if the person has carried on activities at the site or project for a period or periods exceeding **5 months** in aggregate in any 12 month-period. In such situation, payment for these types of services would be subjected to withholding tax under section 107A of the ITA. If the duration of the building site, project or activities is for a period of less than 5 months, withholding tax under section 109B of the ITA will be applicable.

3.9 For services other than those mentioned in paragraph 3.8, withholding tax under section 109B will be applicable.

3.10 For the purpose of determining the duration of activities under paragraph 3.8, the period of activities carried on by a person and its associated persons in Malaysia shall be aggregated if the activities carried on by associated persons are connected with the activity of that person.

3.11 Different activities will be regarded as connected based on the actual facts and circumstances of the case, including in particular:

- (a) whether the contracts covering the different activities were concluded with the same person or its associated persons;
- (b) whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with the person or its associated persons;
- (c) whether the activities would have been covered by a single contract absent tax planning considerations;
- (d) whether the nature of the work involved under the different contracts is the same or similar;
- (e) whether the same employees are performing the activities under the different contracts.

Example 6

L Sdn. Bhd. constructs a facility for the placement and installation of an automated fare collection equipment on a site. The construction of the facility and

the installation of the equipment is carried out by external consultants. L Sdn. Bhd does not have the required expertise and seeks K Co., a related company resident in state K to assist in completing the project. According to the contract between both companies, K Co. is required to complete the project within 6 months. K Co. sends its employees to Malaysia for a period of six months to assist in planning and overseeing the project and to ensure that the appointed external consultant undertakes the task of constructing the facility and installing the equipment on site according to the required specifications and standards. K Co. issues an invoice for the services rendered to L Sdn. Bhd

In this case, K Co. is regarded to have a “place of business” in Malaysia through the supervisory activities for L Sdn. Bhd. for a period of more than 5 months.

Example 7

The facts are the same as in Example 6 except that the supervisory activities carried on by K Co. at the project site is for a period of less than 5 months, K Co. will not be regarded as having a “place of business” in Malaysia.

Although K Co. is not deemed to have a “place of business” in Malaysia due to the time threshold, the income received by K Co. in respect of the supervisory activities carried out for L Sdn. Bhd. would still be subjected to tax under section 4A of the ITA. However, for administrative purpose, whether section 107A or section 109B is applicable would depend on the duration spelt out in the contract.

Agent as “place of business”

3.12 A person (principal) may also be deemed to have a “place of business” in Malaysia if the person has another person acting on his behalf (agent) who:

- (a) habitually concludes contracts; or
- (b) habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification.

The type of contracts covered include those which are in the name of the principal or which are binding on the principal even if those contracts are not in the name of the principal.

Example 8

G Sdn. Bhd., a company in Malaysia promotes, advertises and markets products on behalf of H Co., a related company resident in state H. The activities performed by G Sdn. Bhd. for H Co. includes meeting with customers in Malaysia to promote and to give explanation on products produced by H Co. In addition to that, G Sdn. Bhd. also engages in negotiations which result in the conclusion of contracts between the customers and H Co.

G Sdn Bhd plays the principal role leading to the conclusion of contracts between H Co. and the customers in Malaysia as it engages in the negotiation of the contract. Therefore, H Co will be regarded as having a POB in Malaysia.

For the purpose of determining the activities that would constitute “principal role leading to the conclusion of contracts”, all facts and circumstances will be taken into account.

3.13 In addition, a person (principal) may also be deemed to have a “place of business” in Malaysia if he has an agent who;

- (a) habitually maintains a stock of goods or merchandise in that place of business of the person from which such person delivers goods or merchandise; or
- (b) regularly fills orders on behalf of the person.

3.14 In order for paragraphs 3.13(a) and (b) to apply, the non-resident will be deemed to have a “place of business” if the agent also conducts sales related activities in addition to regularly delivering or regularly filling orders out of the stock of goods or merchandise belonging to the principal.

3.15 For the purpose of paragraphs 3.12 and 3.13, independent agents who act for an enterprise in the ordinary course of their business do not constitute a “place of business” of that person. However, a person is not an independent agent if he acts exclusively, or almost exclusively, on behalf of one or more associated persons.

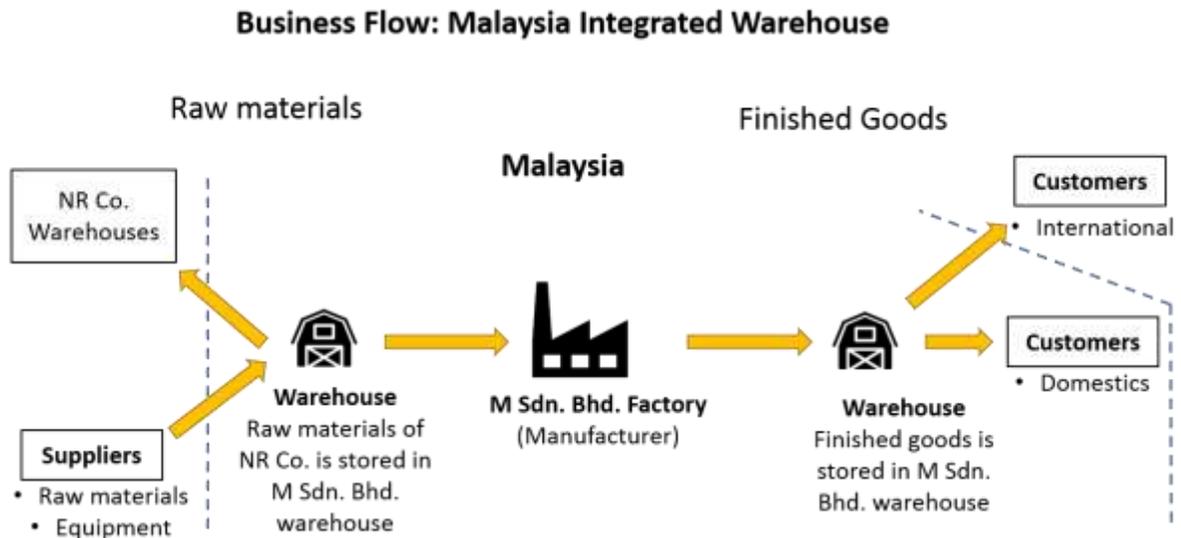
3.16 The application of subsections 12(3) and 12(4) of the ITA is illustrated in the following example.

Example 9

NR Co. Business Model

- (i) NR Co. in country C, is the principal and ultimate holding company of M Sdn. Bhd. M Sdn. Bhd. acts as a toll manufacturer and also provides warehousing facilities to NR Co. in Malaysia. M Sdn. Bhd. receives fees for toll manufacturing, warehousing, storing and delivery of services from NR Co.
- (ii) NR Co. owns the products throughout the entire manufacturing and distribution process. All marketing, selling and distribution functions are conducted by NR Co. It has a sales representative office in Malaysia, however the activity is limited to marketing to new or existing customers and is not authorised to sign contracts.
- (iii) M Sdn. Bhd. owns and manages two warehouses;
 - a private bonded warehouse for the storage of raw materials belonging to NR Co. The raw materials are also delivered to other manufacturers outside Malaysia from the warehouse.
 - a private bonded warehouse for storage of finished goods belonging to NR Co. The warehouse also stores finished goods received from other toll manufacturers outside Malaysia.
- (iv) Personnel of NR Co. are not involved in all the warehouse operations and do not have unrestricted access to the warehouse.

- (v) The warehouse executes only the orders at the request from NR Co. Upon receiving an order, the finished goods will be shipped to customers within or outside Malaysia. The warehouse in Malaysia also supports regional returned shipments and warranty replacement program for regional customers.



The warehouses are not at the disposal of NR Co. Therefore, these places of business by themselves do not constitute 'place of business' to NR Co.. However, the overall activities of NR Co. in Malaysia – including the warehousing activity, the manufacturing of goods as well as the marketing activity of the sales representative office – constitute complementary functions that are part of a cohesive business operation. Consequently, NR Co. would have a place of business in Malaysia.

4. RESPONSIBILITIES

Every person who is liable to tax is required to declare his income to the Inland Revenue Board of Malaysia (IRBM). The responsibilities of a person liable to tax are to:

- register as a taxpayer;

- prepare statement of accounts;
- compute their tax payable;
- submit the Income Tax Return Form through the e-Filing system on or before the due date;
- keep all business records including profit and loss accounts, balance sheet, sales and purchase records, bills, bank statements and stock receipts for a period of 7 years;
- pay the tax payable on the due date.

5. ENQUIRIES

All enquiries with regards to this guideline can be forwarded to:

Tax Policy Department
Inland Revenue Board of Malaysia
Level 17, Menara Hasil
Persiaran Rimba Permai
Cyber 8, Cyberjaya
63000 Selangor, Malaysia.
Tel. No. 03-83138888

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